Computation of GloBE Income or Loss*

The commentary on GLoBE rules[1] and the separate publication on illustrative examples were released in 2022. This paper mainly aims to summarize Chapter 3 of the commentary on the computation of GLoBE income or loss and enlist the mechanism specified in the commentary for calculating GLoBE income or loss. Also, some examples related to Chapter 3 from the illustrative examples' publication[2] of the OECD have been included.

1. A glimpse of Chapter 3 on Computation of GloBE Income or loss

Chapter 3 on the computation of GloBE income or loss is a detailed chapter divided into many articles/ sub-articles explaining the mechanism and the items to be considered for calculating GloBE income or loss. GloBE income or loss forms the denominator for the calculation of the effective tax rate (ETR), which is calculated by the below-mentioned formula:

ETR = Sum of adjusted covered taxes of each constituent entity located in jurisdiction/ **Net GloBE income of jurisdiction***

*(*Net GloBE Income of jurisdiction would be Sum of GloBE Income of all constituent entities located in the jurisdiction minus the Sum of GloBE Losses of all constituent entities located in the jurisdiction)*

Considering that the Net GloBE income forms the denominator in the ETR calculation, the higher the Net GloBE Income, the lower the ETR will be.

The computation should start with the financial accounting net income or loss of the constituent entity; after that, required adjustments specified in different articles of Chapter 3 are to be undertaken. The articles specified in Chapter 3 are stated below - each of the below articles is further divided into several sub-articles (discussed in the next paragraphs):

Article	Description
Article 3.1	**Financial accounting net income or loss** of the constituent entity is to be considered as the starting point
Article 3.2	Required adjustments are made for **differences between financial accounting and taxable income** (for ex. - exclusion of dividend income, adding-back of the illegal payments)
Article 3.3	**International shipping income and qualified ancillary international shipping income are specifically excluded**
Article 3.4	**Deals with the allocation of income or loss between the main entity and the permanent establishment**
Article 3.5	**Deals with the allocation of income or loss derived through a flow-through entity to other constituent entities**

* Compiled by Nupur Jalan, Ms Jalan is a tax professional specializing in corporate tax, international tax and transfer pricing and an interdisciplinary researcher. She can be contacted at jalannupur@outlook.com

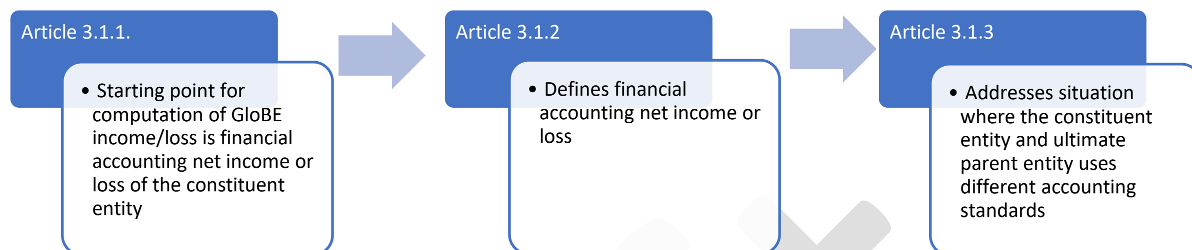
[1] Chapter 3, Tax Challenges Arising from the Digitalisation of the Economy – Commentary to the Global Anti-Base Erosion Model Rules (Pillar Two), pg. 43-84 (OECD 2022), https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two-commentary.pdf

[2] Chapter 3 - Examples, Tax Challenges Arising from the Digitalisation of the Economy –Global Anti-Base Erosion Model Rules (Pillar Two) Examples, pg. 23-32 (OECD 2022), https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisationof-the-economy-global-anti-base-erosion-model-rules-pillar-two-examples.pdf

3. Detailed discussion article wise

Article 3.1[3]: Financial Accounts

This article is divided into three sub-articles, as shown below:



Article 3.1.1 mainly highlights that the computation of GloBE income or loss should begin with the financial accounting net income or loss of the constituent entity. Then required adjustments are made for items of income, gain, loss, and expense mentioned in the other articles/ sub-articles of the chapter.

Article 3.1.2 lays down the meaning of the financial accounting net income or loss. For the determination of GloBE income or loss, net income/ loss determined for all constituent entities (taking account of income/ expenses including income taxes and before consolidation adjustments eliminating intra-group transactions) in preparing the consolidated financial statement of the ultimate parent entity is to be considered. In this, the following points need consideration:

- The impact of intra-group transactions of income and expenses plus adjustments to income or expenses attributable to purchase accounting for an acquired business, when considered at a consolidated level, is not to be considered.
- Other expenses (for example, stock-based compensation), even though consolidated, may be considered separately where tracing can be done at the constituent entity level.
- A constituent entity may not consider 'push down' adjustments to the carrying value of assets and liabilities attributable to purchasing a business if the acquisition date is on or after 1 December 2021.
- The net income or loss of the constituent entity has to be determined using the accounting standard used to determine the constituent entity's income or loss in preparing the consolidated financial statements.
- Other comprehensive income (OCI) sections of the consolidated financial statements (rather than in the profit and loss statement) are generally excluded from the computation of GloBE income or loss. This exception includes the revaluation method gain or loss (discussed later).

Further, there could be a situation where the constituent entity maintains its entity-level financial accounts using an accounting standard different from the standard used in the preparation of the ultimate parent entity (UPE) consolidated financial statements. Article 3.1.3 intends to address such

[3] Ibid n. 1, Chapter 3, Tax Challenges Arising from the Digitalisation of the Economy – Commentary to the Global Anti-Base Erosion Model Rules (Pillar Two), pg. 43-46

situations. Where required, different accounting standards can be used, subject to the following conditions:

- The financial accounts of the constituent entity are maintained based on an acceptable[4] or authorized financial accounting standard (adjusted for material, competitive distortions). Where the constituent entity does not maintain its financial accounts based on an acceptable financial accounting standard or authorized financial accounting standard, it must compute its financial accounting income using the UPEs financial accounting standard, notwithstanding any practical difficulties.
- The information in the financial accounts maintained according to the other accounting standard is reliable.
- The use of the other accounting standard should not result in permanent differences over EUR 1 million from the financial accounting standard of the UPE. However, if the permanent differences exceed EUR 1 million in the aggregate, the treatment of the relevant items must be adjusted in the constituent entity's financial accounts to conform to the treatment that would have been accorded in the UPEs financial accounting standard. This only applies to permanent differences items between the accounting standards. It doesn't apply to the items giving rise to timing differences.

Article 3.2[5]: Adjustments for differences in GloBE Income or Loss

It has eleven sub-articles (mentioned in the table below), and adjustments are generally related to permanent difference items arising because of the difference in the treatment of different items under financial accounting and local tax rules.

Sub-article	Description
Article 3.2.1	Sets out nine adjustments to the financial accounting net income or loss that are required in the computation of each constituent entity's GloBE income or loss
Article 3.2.2	Deals with the treatment of stock-based compensation
Article 3.2.3	Deals with the arm's length requirement for cross-border transactions
Article 3.2.4	Deals with the treatment of qualified refundable tax credits
Article 3.2.5	Provides election to use realization method instead of fair value accounting
Article 3.2.6	Provides election to spread capital gains over five years
Article 3.2.7	Provides special rule for intragroup financing arrangements
Article 3.2.8	Deals with elections to consolidate transactions in the same jurisdiction
Article 3.2.9	Deals with the exclusion of certain insurance company income

[4] Art. 10.1.1 defines "Acceptable Financial Accounting Standard": *"means International Financial Reporting Standards (IFRS) and the generally accepted accounting principles of Australia, Brazil, Canada, the Member States of the European Union, the Member States of the European Economic Area, Hong Kong (China), Japan, Mexico, New Zealand, the People's Republic of China, the Republic of India, the Republic of Korea, Russia, Singapore, Switzerland, the United Kingdom, and the United States of America."* (Refer Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two): Inclusive Framework on BEPS, pg. 52 (OECD 2021), https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-theeconomy-global-anti-base-erosion-model-rules-pillar-two.htm.)

[5] Ibid n. 1, Chapter 3, Tax Challenges Arising from the Digitalisation of the Economy – Commentary to the Global Anti-Base Erosion Model Rules (Pillar Two), pg. 46-70

Article 3.2.10	Deals with the treatment of additional tier-one capital
Article 3.2.11	States that adjustments can be made per the requirements of chapters 6 and 7, where necessary

Note: Further, to the extent, an adjustment required by Article 3.2 excludes an amount of income from the GloBE income or loss computation, any covered taxes associated with that income must also be excluded from the adjusted covered taxes.

Article 3.2.1 sets out the nine adjustments (discussed below) to the financial accounting net income or loss required in each constituent entity's GloBE income or loss computation.

A glimpse of adjustments in Article 3.2.1		
Paragraph (a) - Net Taxes Expense	**Paragraph (b) - Excluded Dividends**	**Paragraph (c) - Excluded Equity Gains or Losses**
Paragraph (d) - Included Revaluation Method Gain or Loss	**Paragraph (e) - Gain or loss from the disposition of assets and liabilities excluded under Article 6.3**	**Paragraph (f) - Asymmetric Foreign Currency Gains or Losses**
Paragraph (g) - Policy Disallowed Expenses	**Paragraph (h) - Prior Period Errors and Changes in Accounting Principles**	**Paragraph (i) - Accrued Pension Expense**

Paragraph (a): Net Taxes Expense: Per this, the net tax expense is added back to the constituent entity's financial accounting net income or loss. Net tax expense is the net amount of[6]:

'a. any Covered Taxes[7] accrued as an expense and any current and deferred Covered Taxes included in the income tax expense, including Covered Taxes on income that is excluded from the GloBE Income or Loss computation
b. any deferred tax asset[8] attributable to a loss for the Fiscal Year;
c. any Qualified Domestic Minimum Top-up Tax[9] accrued as an expense;
d. any taxes arising under the GloBE Rules accrued as an expense; and
e. any Disqualified Refundable Imputation Tax accrued as an expense[10]'

Points a and b above mainly cover items (like current and deferred tax expense, portion of deferred tax assets created for loss of the Fiscal Year) that are considered in arriving at the net income of the multinational enterprises (MNEs) – however, these are added back in the computation of GloBE income or loss. Points c and d are tax liabilities accrued per the GloBE rule and should not be considered as an expense in the calculation of GloBE income or loss (like, for ex., qualified domestic minimum top-up tax (QDMTT) are not included in Chapter 4: Covered taxes and hence related expenses are excluded here). Point e covers disqualified refundable imputation tax expenses accrued

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[6] Refer Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two): Inclusive Framework on BEPS, pg. 62 (OECD 2021), https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-theeconomy-global-anti-base-erosion-model-rules-pillar-two.htm.

[7] Refer to Article 4.2., Definition of Covered Taxes, Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two): Inclusive Framework on BEPS, pg. 23 (OECD 2021), https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-theeconomy-global-anti-base-erosion-model-rules-pillar-two.htm.

[8] Relates to the taxes that are receivable/recoverable in future because of deductible temporary differences or the carry forward of tax losses/ credits

[9] Refer Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two): Inclusive Framework on BEPS, pg. 64 (OECD 2021), https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-theeconomy-global-anti-base-erosion-model-rules-pillar-two.htm.

[10] Ibid 9, pg. 55

(the same is included in Chapter 4: Covered taxes and hence related expenses are excluded here), which are to be added back for computation of the GloBE income or loss.

Hypothetical example

Facts:

Profit or loss (not considering OCI items): 5000 EUR; Covered taxes: 200 EUR; QDMTT: 100 EUR, Disqualified Refundable Imputation Tax: 50EUR

Particulars	Amount (in EUR)
Profit or loss (a)	5.000
Covered taxes (b)	200
QDMTT (c)	100
Disqualified Refundable Imputation Tax (d)	50
Total (a+b+c+d)	**5.350**

Paragraph (b) - Excluded Dividends[11]

Adjustments are made to the constituent entity's financial accounting net income or loss by the amount of any excluded dividends received during the Fiscal year. However, there is an exception concerning the portfolio holdings.[12] and short-term portfolio shareholding[13] (as shown in the table below).

Dividends or other distributions received/ accrued	Portfolio shareholding (carrying rights of less than 10% of the profits, capital, reserves or voting rights of the distributing entity)	Non-Portfolio shareholdings (carrying rights of 10% or more of the profits, capital, reserves or voting rights of the distributing entity)
Short-term shareholding (shareholding held for less than a year)	Included dividend	Excluded dividend
Non-Short term shareholding (shareholding held for a year or more)	Excluded dividend	Excluded dividend

Modified diagram, Source: Chapter 3, Tax Challenges Arising from the Digitalisation of the Economy – Commentary to the Global Anti-Base Erosion Model Rules (Pillar Two), pg. 51 (OECD 2022), https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two-commentary.pdf

The below examples are taken from the illustrative examples published by the OECD.[14]

[11] Para. 10.1.1 provides a definition of "Excluded Dividends": "dividends or other distributions received or accrued in respect of an Ownership Interest, except for (a) a Short-term Portfolio Shareholding, and (b) an Ownership Interest in an Investment Entity that is subject to an election under Article 7.6 1 ." (Refer Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two): Inclusive Framework on BEPS, pg. 56 (OECD 2021), https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-theeconomy-global-anti-base-erosion-model-rules-pillar-two.htm.)

[12] Refer ibid 9, pg. 64, Art.10.1.1 provides definitions of "Portfolio Shareholding": "means Ownership Interests in an Entity that have been held by the MNE Group and that carry rights to less than 10% of the profits, capital, reserves, or voting rights of the Entity at the date of the distribution or disposition."

[13] Refer ibid 9, pg. 65, Art.10.1.1 definitions of Short-term Portfolio Shareholding: "means a Portfolio Shareholding that has been economically held by the Constituent Entity that receives or accrues the dividends or other distributions for less than one year at the date of the distribution."

[14] Chapter 3, Tax Challenges Arising from the Digitalisation of the Economy –Global Anti-Base Erosion Model Rules (Pillar Two) Examples, OECD (2022), pg. 23-24, https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisationof-the-economy-global-anti-base-erosion-model-rules-pillar-two-examples.pdf.

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Example 3.2.1(b) - 1 Dividend and Short-term Portfolio Shareholding

Facts:

- A Co is a constituent entity of an MNE Group. B Co (unrelated to A Co.) and has 10,000 ordinary shares with equal rights to profit distributions and capital.
- A Co acquires 200 common shares in B Co on 1 July in Year 1 and an additional 100 common shares in B Co on 31 March in Year 2. B Co distributes a dividend of EUR 0.10 per share on 31 December of Year 2 (shown in the table below).

Particulars	Year 1	Year 2
Jan.- March	-	Acquisition of 100 shares on 31 March
April- June	-	
July – Sept.	Acquisition of 200 shares on 1 July	
Oct. Dec.	-	Total dividend of 30 paid on 300 shares on 31 December

Data source: OECD (2022), Tax Challenges Arising from the Digitalisation of the Economy –Global Anti-Base Erosion Model Rules (Pillar Two) Examples, pg. 23

- A Co is a member of an MNE Group that holds less than 10% of the shares (i.e., portfolio shareholding) in B Co

Treatment under the chapter on the computation of GloBE income or loss:

A Co holds a portfolio shareholding (i.e., less than 10% of the shares in B Co) at the dividend payment date. One hundred of these shares (shares acquired on 31 March in Year 2) would be treated as a short-term portfolio shareholding under the GloBE Rules (because of a holding period of less than 12 months at the dividend date). The dividends received on these shares of 10 (100 shares x 0.10) will be considered in calculating A Co's GloBE income, and 20 (200 shares x 0.10) of the dividends received by A Co for the remaining 200 shares (i.e., for shares acquired on 01 July in Year 1) will be treated as an excluded dividend.

Example 3.2.1(b) - 2 Excluded Dividend and Short-term Portfolio Shareholding

Facts:

- The facts are similar to the above example.
- The additional event vis-a-vis is the disposal of 40 shares by A Co of B Co on 30 September in Year 2 (shown in the table below).

Particulars	Year 1	Year 2
Jan.- March	-	Acquisition of 100 shares on 31 March
April- June	-	
July – Sept.	Acquisition of 200 shares on 1 July	Sale of 40 shares on 30 September
Oct. Dec.	-	Total dividend of 26 paid on remaining 260 shares on 31 December

Data source: OECD (2022), Tax Challenges Arising from the Digitalisation of the Economy –Global Anti-Base Erosion Model Rules (Pillar Two) Examples, pg. 25

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Treatment under the chapter on the computation of GloBE income or loss:

For sale made by A Co of B Co shares, it will be deemed that A Co has disposed the most recently acquired shares. As of the date of distribution of dividend on the shares, out of the remaining 260 shares after the sale, 60 shares are to be treated as a short-term portfolio shareholding under the GloBE rules (because these 60 shares are held for less than 12 months as on 31 December in Year 2). Accordingly, the dividend received on these shares of 6 (60 shares x 0.10) will be considered in calculating A Co's GloBE income and 20 (200 shares x 0.10) of the dividends received by A Co for the remaining 200 shares will be treated as an excluded dividend.

Example 3.2.1(b) - 3 Excluded Dividend and Short-term Portfolio Shareholding

Facts:
- The facts are similar to the above example.
- The only fact that has changed vis-a-vis the previous example is that A Co. disposed of 50 shares on 31 December of Year 1, and no further shares were disposed of in Year 2 (shown in the table below).

Particulars	Year 1	Year 2
Jan.- March	-	Acquisition of 100 shares on 31 March
April- June	-	
July – Sept.	Acquisition of 200 shares on 1 July	
Oct. Dec.	Sale of 50 shares on 31 December	Total dividend of 25 paid on remaining 250 shares on 31 December

Data source: OECD (2022), Tax Challenges Arising from the Digitalisation of the Economy –Global Anti-Base Erosion Model Rules (Pillar Two) Examples, pg. 24

Treatment under the chapter on the computation of GloBE income or loss:

For sale made by A Co of B Co shares, it will be deemed that A Co has disposed the most recently acquired shares. As of the date of distribution of dividend on the shares, out of the remaining 250 shares after the sale, 100 shares are to be treated as a short-term portfolio shareholding under the GloBE Rules (because these 100 shares are held for less than 12 months as on 31 December in Year 2). The 50 shares sold by A Co would be from the 200 shares acquired by A Co on 1 July in Year 1. Accordingly, the dividend received on these shares of 10 (100 shares x 0.10) will be considered in calculating A Co's GloBE income, and only 15 (150 shares x 0.10) of the dividends received by A Co in respect of the remaining 150 shares will be treated as an excluded dividend.

Paragraph (c) - Excluded Equity Gains or Losses[15]

It includes the following three categories of gain or loss attributable to an ownership interest:

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[15] Ibid 9, pg. 56, Article 10.1.1 provides the definition - Excluded Equity Gain or Loss means the gain, profit or loss included in the Financial Accounting Net Income or Loss of the Constituent Entity arising from (a) gains and losses from changes in fair value of an Ownership Interest, except for a Portfolio Shareholding; (b) profit or loss in respect of an Ownership Interest included under the equity method of accounting; and (c) gains and losses from disposition of an Ownership Interest, except for a disposition of a Portfolio Shareholding.

a. **Gains and losses from changes in the fair value of the ownership interest (except for a portfolio shareholding)** - Under the fair value method, the ownership interest is revalued periodically, and any changes in the value are treated as gain or loss in that period (in the profit and loss statement or OCI). For ex., there is a negative adjustment for excluded fair value gains.

b. **Profit or loss in respect of an ownership interest that is included in financial accounting net income or loss under the equity method of accounting** - Per the accounting standards, MNEs have to follow equity method accounting for reporting the ownership interest, where the MNE group holds a non-controlling interest in an entity. Since these entities are not constituent entities, hence adjustments are to be made for these in the computation of GloBE income and loss.

c. **Gains and losses from disposition of an ownership interest (except for a portfolio shareholding)** - These generally create permanent difference because they are generally not included in the seller's taxable income. Hence, the permanent difference is eliminated by excluding such gains and losses from dispositions of ownership interests from the GloBE income or loss.

Paragraph (d) - Included Revaluation Method Gain or Loss[16]

It requires all included revaluation method gain or loss for the Fiscal year to be included in the calculation of GloBE income or loss. This paragraph provides an option to make an election under Article 3.2.5 for tangible properties that are subject to the revaluation model. Where an election is made, the gains or losses in the OCI would be deferred till the asset is disposed and such gains or losses would not be included in the computation of GloBE Income or Loss. Accordingly, the covered taxes associated with such gains and losses would also be deferred until the disposal of the asset. The net revaluation gain is added to the profit or loss, and the net revaluation loss is deducted from the profit and loss.

Hypothetical example
Facts:
Profit or loss (not considering OCI items): 5000 EUR; Net gain from included revaluation gain or loss: 1000 EUR; Associated Covered taxes: 200 EUR

Particulars	Amount (in EUR)
Profit or loss (a)	5.000
Net gain from included revaluation gain or loss (b)	1.000
Associated Covered taxes (c)	200
Total (a+b+c+d)	**6.200**

Paragraph (e) - Gain or loss from the disposition of assets and liabilities excluded under Article 6.3[17]

This paragraph mainly requires the inclusion of gain or loss arising from a transfer of assets (other than ownership interests that are not portfolio shareholdings) and liabilities excluded in Article 6.3 for the computation of GloBE income or loss. Article 6.3 mainly excludes gain or loss that arises on the

[16] Ibid 9, pg. 58, Art. 10.1.1 provide a definition - Included Revaluation Method Gain or Loss means the net gain or loss, increased or decreased by any associated Covered Taxes, for the Fiscal Year in respect of all property, plant and equipment that arises under an accounting method or practice that: (a) periodically adjusts the carrying value of such property to its fair value; (b) records the changes in value in Other Comprehensive Income, and (c) does not subsequently report the gains or losses recorded in Other Comprehensive Income through profit and loss.

[17] Article 6.3.2 mainly intends to exclude any gain or loss on the disposition of assets and liabilities between the constituent entities as part of GloBE reorganization.

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disposition of assets and liabilities between the two constituent entities as a consequence of a GloBE reorganization. Thus, the net gain from disposal is added back into the profit/ loss, and the net loss from disposal is deducted from the profit/ loss.

Paragraph (f) - Asymmetric Foreign Currency Gains or Losses

Generally related to foreign currency exchange (FX) gains or losses that arise due to differences between the functional currency for accounting purposes and the one used for local tax purposes. It requires a negative adjustment to financial accounting net income or loss in the amount of the accounting FX gain and a positive adjustment to financial accounting net income or loss in the amount of the accounting FX loss.

The below examples are taken from the illustrative examples published by the OECD.[18]

Article 3.2.1(f) – 1: Asymmetric Foreign Currency Gains or Losses

Facts

- A Co is in Country A and is part of an MNE Group on which GloBE rules apply. A Co's accounting and tax reporting period corresponds to the calendar year.
- The functional currency used by A Co for tax purposes is Euros and for accounting purposes is US Dollars. The EUR€:US$ exchange rate is as follows:
  - Beginning of the year: €1:$1
  - End of the year: €1:$1.25
- The face value of non-interest-bearing bonds that A Co holds at the start of Year 1 is $1,000. The fall in the value of the bond in euro terms of €200 ([€1,000 / 1.25] - €1,000) needs to be taken into consideration in A Co’s taxable income (shown in the table below).
- The table on the left shows A Co’s profit and ETR for local tax purposes, while the table on the right shows the same calculations for accounting purposes (calculated in dollars). For tax purposes, other income is also converted at the year-end exchange rate of €1:$1.25.

Tax Functional Currency (Euros)		**Accounting Functional Currency (Dollars)**	
Other income	500	Other income	625
Foreign currency gain (loss)	(200)	Foreign currency gain (loss)	-
Total profit	300	Total profit	625
Country A tax	60	Tax	75
ETR	20%	ETR	12%

Source: OECD (2022), Tax Challenges Arising from the Digitalisation of the Economy –Global Anti-Base Erosion Model Rules (Pillar Two) Examples, pg. 25

[18] Chapter 3, Tax Challenges Arising from the Digitalisation of the Economy –Global Anti-Base Erosion Model Rules (Pillar Two) Examples, OECD (2022), pg. 25-28, https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisationof-the-economy-global-anti-base-erosion-model-rules-pillar-two-examples.pdf.

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Treatment under the chapter on the computation of GloBE income or loss:

The FX loss for tax purposes in the above table would fall in this paragraph, and appropriate adjustments need to be made for it in the computation of GloBE income or loss. The dollar value of the FX loss of 200 Euro (taken for tax purposes) is included as a negative adjustment to the financial accounting net income or loss of A Co (as shown below)

Accounting Functional Currency (Dollars)	
Other income	625
Asymmetric Foreign Currency Gain (Loss) adjustment	(250)
Total profit	375
Country A tax	(75)
ETR	20%

Source: OECD (2022), Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two) Examples, pg. 26

Example 3.2.1(f) - 2 Asymmetric Foreign Currency Gains or Losses

Facts

- A Co is in Country A and is part of an MNE Group on which GloBE Rules apply. The accounting and tax reporting period for A Co. corresponds to the calendar year.
- The functional currency used by A Co for tax purposes is Euros, and for accounting purposes is US Dollars.
- The EUR€:US$ exchange rate is as follows:
  - End of Year 1: €1:$1
  - Year 2: €1:$1.25
- Year 1: A Co. enters into a loan agreement denominated in Euros at the start of Year 1 and accrues interest expense of EUR 500 in Year 1. The amount of interest expense accrued in the accounting books remains the same as the exchange rate at the end of Year 1 is €1:$1.
- Year 2: A Co pays EUR 500 of interest expense accrued in Year 1. The amount corresponds to $625 because of the prevailing exchange of €1:$1.25. Consequently, an additional interest expense of $125 needs to be booked for financial accounting purposes. (shown in the table below)
- The difference arising in financial accounts books, though, does not result in any taxable gain or loss as the loan and the interest expense were denominated in the tax functional currency, Euros.

Tax Functional Currency (Euros)		Accounting Functional Currency (Dollars)	
Other income	1,000	Other income	1,250
Foreign currency gain (loss)	-	Foreign currency gain (loss)	125
Total profit	1,000	Total profit	1,125
Tax	(200)	Tax	(250)
ETR	20%	ETR	22.2%

Source: OECD (2022), Tax Challenges Arising from the Digitalisation of the Economy –Global Anti-Base Erosion Model Rules (Pillar Two) Examples, pg. 26

**For the purpose of above example, the amount in Euros are also denominated in comma separator instead of decimal separator*

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Treatment under the chapter on the computation of GloBE income or loss:

In the current case, the strengthening of the Euro results in an increase of interest payable for A Co in dollar terms (thereby creating foreign currency loss) for financial accounts. Therefore, ETR for financial accounts turns out to be 22.2% which is greater than the ETR of 20% for tax accounts.

This FX loss falls in financial accounts within paragraph (b) of the definition of Asymmetric Foreign Currency Gains or Losses, and necessary adjustments are required for it. (Shown in the table below)

Accounting Functional Currency (Dollars)	
Other income	1250
Foreign Currency Gain (Loss)	(125)
Asymmetric Foreign Currency Gain (Loss) Adj.	125
Total profit	1,250
Country C tax	(250)
ETR	20%

Source: OECD (2022), Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two) Examples, pg. 27

Paragraph (g) - Policy Disallowed Expenses

This paragraph deals with the adjustment needed for policy disallowed expenses. Policy disallowed expenses are defined in Article 10.1[19] to mean expenses accrued by the constituent entity for illegal payments, including bribes and kickbacks, and expenses accrued by the constituent entity for fines and penalties. For ex.: Bribes, kickbacks, and other illegal payments are allowed expenses under financial accounting rules but may not be deductible for tax purposes. The rule applies where fines and penalties that equal or exceed EUR 50.000 (or an equivalent amount in the functional currency in which the constituent entity's financial accounting net income or loss was calculated). There is no such threshold for bribes and kickbacks, which are always disallowed.

Paragraph (h) - Prior Period Errors and Changes in Accounting Principles

Prior period errors and changes in accounting principles are defined in Article 10.1[20] to mean changes in the opening equity, i.e., the equity at the beginning of the Fiscal Year of a constituent entity attributable to a correction of a prior period error generally, that affected the computation of GloBE Income or Loss in a previous Fiscal Year or a change in accounting principle or policy that affects income or expenses includible in the calculation of GloBE Income or Loss. It does not apply to an error correction that requires a corresponding decrease in covered taxes in a previous Fiscal Year of EUR 1 000000 or more.

However, an adjustment under this paragraph is not needed where the:

- Where the error is attributable to a Fiscal year prior to applying the GloBE Rules to the constituent entity, the adjustment to opening equity does not result in an adjustment under Article 3.2.1(h) because it did not affect the computation of GloBE income or loss

[19] Refer ibid 9, pg. 64

[20] Refer Ibid 9, pg. 64

- If the adjustment is a decrease that requires re-computation of the ETR and top-up tax for a previous Fiscal Year under Article 4.6.1, an adjustment under Article 3.2.1(h) is not needed because the adjustment is made in the relevant Fiscal Year under Article 4.6.1

To the extent the equity adjustment is attributable to items of income or expense that were, or would have been, included in the computation of GloBE income or loss, it must be treated as an increase or decrease to the financial accounting net income or loss of the relevant constituent entity or constituent entities. To the extent that the adjustment relates to Fiscal Years prior to applying the GloBE Rules to the constituent entity, it is excluded from the computation of GloBE income or loss.

Paragraph (i) - Accrued Pension Expense[21]: Pension liabilities are allowed as expenses in the computation of GloBE income or loss to the extent of contributions to a pension fund during the Fiscal Year. The adjustment for accrued pension expense required by Article 3.2.1(i) is equal to the difference between (a) the amount of pension contributions during the year and (b) the amount accrued as an expense in the computation of financial accounting net income or loss during the Fiscal Year. The adjustment to financial accounting net income or loss for this difference will be a positive amount if the amount accrued as an expense in the financial accounts exceeds the contributions for the year. It will be a negative amount in Fiscal Years in which the contributions exceed the expense accrued in the financial accounts. For example, if expenses for pension liability are 200EUR and the amount of pension contributions towards the year is 160EUR, then the accrued pension expense would be 40EUR.

Article 3.2.2 Stock-based Compensation

This sub-article provides an election to substitute in the computation of GloBE income or loss the amount of stock-based compensation allowed as a deduction in the calculation of a constituent entity's taxable income in place of the amount expensed in its financial accounts. Where the election is not made, the constituent entity computes its GloBE income or loss, considering the amount of stock-based compensation allowed in the computation of its financial accounting net income or loss. The scope of the election is limited to compensation expenditures in the form of stock, stock options, stock warrants (or an equivalent), where the amount allowed as an expense is computed differently for local tax purposes than for financial accounting purposes.

An election is to be made by the filing constituent entity, and the election brings the GloBE income or loss more into line with the local tax rules in those jurisdictions that allow a deduction based on the stock value at the exercise date.

Suppose the election is made in respect of an option that expires without exercise. In that case, the constituent entity must treat the amount previously included as an expense in the computation of the GloBE income or loss under the election as additional income under the GloBE rules.

- An election is a five-year election and must be applied consistently
- An election is made on a jurisdictional basis and thus can be made for some jurisdictions and not other jurisdictions

Further, revocation of the election is made on a jurisdictional basis.

[21] Refer Ibid 9, pg. 52,
Art. 10.1.1 provides the definition - Accrued Pension Expense mean the difference between the amount of pension liability expense included in the Financial Accounting Net Income or Loss and the amount contributed to a Pension Fund for the Fiscal Year.

Article 3.2.3: Arm's length requirement for cross-border transactions

This sub-article deals with the arm's length requirement for cross-border transactions. The issues covered are:

- When transactions are not recorded in the same amount in the financial accounts of both constituent entities
- When a transaction is not consistent with the arm's length principle

Certain differences may arise because of the transfer price audit adjustment. These differences may occur where:

a. a unilateral APA has been agreed;
b. a constituent entity files a tax return under a self-assessment system that includes book-to-tax adjustments to comply with domestic transfer pricing rules or tax authority challenges and adjusts the transfer price used in the local tax return of one of the constituent entities.

The below examples are taken from the illustrative examples published by the OECD.[22]

Article 3.2.3 (Example 3.2.3 – 1): Arm's Length Requirement for cross-border transactions

- A Co is in Jurisdiction A, B Co is in Jurisdiction B, are constituent entities of the same MNE Group.
- The nominal tax rate in Jurisdiction A is 25%, and Jurisdiction B does not impose an income tax on Entities.
- In Year 1, B Co provides services to A Co. In financial accounts, A Co records an expense of 100, and B Co records an income of 100 for the services B Co provides. For tax purposes, A Co deducts 150 in respect of the services.

Treatment under the chapter on the computation of GloBE income or loss:

This sub-article requires transactions between group entities to be at the same price and consistent with the arm's length principle. To prevent double taxation or double non-taxation under the GloBE rules, Article 3.2.3 requires an adjustment to the financial accounting net income or loss when a constituent entity claims an amount of income or expense in a tax return attributable to a controlled transaction that differs from the amount reflected in the financial accounts.

A Co reported 150 expenses in its Jurisdiction A tax return for Year 1 and 100 expenses in its financial accounts for Year 1. B Co only reported 100 of income in its financial accounts in Year 1. As a result, 50 of the MNE Group's income is not subject to tax in Jurisdiction A and is not exposed to top-up tax in Jurisdiction B. Therefore, A Co has to consider additional expenses of 50 in the computation of its GloBE Income or Loss for Year 1, and B Co has to include 50 of additional income in the computation of its GloBE Income or Loss for Year 1.

Example 3.2.3 – 2: Arm's Length Requirement for Cross-border Transactions

Facts:
- The facts are similar as that of Example 3.2.3 – 1 above

[22] Chapter 3, Tax Challenges Arising from the Digitalisation of the Economy –Global Anti-Base Erosion Model Rules (Pillar Two) Examples, OECD (2022), pg. 28-29 , https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisationof-the-economy-global-anti-base-erosion-model-rules-pillar-two-examples.pdf.

- The only additional fact is that A Co stated 80 of the expense from the transaction with B Co in its tax return in Jurisdiction A. This was done under a unilateral Advance Pricing Agreement concluded with Jurisdiction A.

Treatment under the chapter on the computation of GloBE income or loss:

A Co stated 80 expenses in its tax return for Year 1 and 100 expenses in its financial accounts for Year 1. B Co stated 100 of income in its financial accounts in Year 1. As a result, A Co is subject to tax in Jurisdiction A on 20 of income that is also exposed to top-up tax in Jurisdiction B. Article 3.2.3, therefore, requires A Co to reduce the expense by 20 in the computation of its GloBE income or loss and B Co to include 20 less income in the computation of its GloBE income or loss.

Article 3.2.4: Qualified Refundable Tax Credits

There are incentives given by the Government to offset to engage in certain activities, such as research and development, whereby the Government allows the company to offset its taxes dollar-for-dollar for engaging in specified activities or incurring specified expenditures, or the amount of the unused credit is refunded if the company doesn't have any tax liability.

Per this article, the total amount of a qualified refundable tax credit[23] will be treated as GloBE income of the recipient constituent entity in the year when such entitlement accrues.

Article 3.2.5: Election to use realization method in lieu of fair value accounting

Under this, a constituent entity must exclude fair value or impairment gain or loss in respect of assets or liabilities subject to the election from the computation of GloBE income or loss. It must include gain or loss determined under the realization method.

An election under Article 3.2.5 is a five-year election. Where an election is revoked, the GloBE income or loss is adjusted by the difference between the fair value of the asset or liability at the beginning of the year and the carrying value of the asset or liability determined under the election.

Article 3.2.6 Election to spread capital gains over five years

This article provides the option for an election for the MNE group to spread the effect of gains and losses from the sale of local tangible assets for up to five years to mitigate the impact of recognizing the entire gain in a single year on the MNE group's jurisdictional ETR computation and to match the timing of gains and losses on local tangible assets. This article is only relevant for gains from immovable property in that jurisdiction, excluding any gain or loss on the transfer of assets between group members.

The below examples are taken from the illustrative examples published by the OECD.[24]

[23] Refer Ibid 9, pg. 52, Article 10.1.1 provides the definition - Qualified Refundable Tax Credit means a refundable tax credit designed in a way such that it must be paid in cash or available as cash equivalents within four years from when a Constituent Entity satisfies the conditions for receiving the credit under the laws of the jurisdiction granting the credit. A tax credit that is refundable in part is a Qualified Refundable Tax Credit to the extent it must be paid in cash or available as cash equivalents within four years from when a Constituent Entity satisfies the conditions for receiving the credit under the laws of the jurisdiction granting the credit. A Qualified Refundable Tax Credit does not include any amount of tax creditable or refundable pursuant to a Qualified Imputation Tax or a Disqualified Refundable Imputation Tax.

[24] Chapter 3, Tax Challenges Arising from the Digitalisation of the Economy –Global Anti-Base Erosion Model Rules (Pillar Two) Examples, OECD (2022), pg. 29-30, https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisationof-the-economy-global-anti-base-erosion-model-rules-pillar-two-examples.pdf.

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Example 3.2.6 – 1: Election to Spread Capital Gains Over Five Years

- A Co is a constituent entity of an MNE Group. A Co is incorporated and tax resident in Country A and holds local tangible assets.
- In Year 3, A Co disposed of a local tangible asset and incurred a net asset loss of EUR 25.
- In Year 5, A Co disposed of its remaining local tangible assets for EUR 300. The carrying value of the local tangible assets disposed of in Year 5 was EUR 100. As a result, a net asset gain of EUR 200 was realized in Year 5.
- A Co made an annual election under Article 3.2.6 concerning the net asset gain in Year 5.

Treatment under the chapter on the computation of GloBE income or loss:

In Year 5, with the disposal of its local tangible assets, A Co realised an aggregate asset gain of EUR 200. Since a net asset loss of EUR 25 was incurred in Year 3, A Co first must allocate EUR 25 of the aggregate asset gain to Year 3 under Article 3.2.6 (b). This is because Article 3.2.6(b) provides that aggregate asset gain in the election year must first be carried back to the earliest loss year and set off against any net asset loss.

Then, pursuant to Article 3.2.6(d), A Co must allocate the remaining EUR 175 evenly to each Fiscal Year in the look-back period, which consists of the four prior Fiscal Years and the Election Year. This would result in a carry-back of EUR 35 to each Fiscal Year in the look-back period. Article 3.2.6 is an ETR adjustment Article. Pursuant to Article 5.4.1, A Co's GloBE Income or Loss, ETR, and Top-up Tax must be recalculated for each of the prior Fiscal Years in the look-back period by including all the aggregate asset gain allocated to each year under Article 3.2.6(d).

Article 3.2.7 Special Rule for Intragroup Financing Arrangements

This article contains rules concerning intragroup financing arrangements[25] that increase the amount of expenses considered in computing the GloBE income or loss of a low-tax entity[26] and do not result in a corresponding increase to the taxable income of the high-tax counterparty to such an arrangement. This rule prevents MNE groups from engaging in transactions intended to increase the ETR in a jurisdiction below the minimum rate by reducing the GloBE income or loss in such jurisdiction without increasing the taxable income of the counterparty to the arrangement.

The below examples are taken from the illustrative examples published by the OECD.[27]

[25] Refer Ibid 9, pg. 58, Art. 10.1.1 provides the definition - Intragroup Financing Arrangement means any arrangement entered into between two or more members of the MNE Group whereby a High Tax Counterparty directly or indirectly provides credit or otherwise makes an investment in a Low Tax Entity.

[26] Refer Ibid 9, pg. 60, Art. 10.1.1 provides the definition - Low-Tax Entity means a Constituent Entity located in a Low Tax Jurisdiction or a jurisdiction that would be a Low-Tax Jurisdiction if the Effective Tax Rate for the jurisdiction were determined without regard to any income or expense accrued by that Entity in respect of an Intragroup Financing Arrangement.

[27] Chapter 3, Tax Challenges Arising from the Digitalisation of the Economy –Global Anti-Base Erosion Model Rules (Pillar Two) Examples, OECD (2022), pg. 30-31, https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisationof-the-economy-global-anti-base-erosion-model-rules-pillar-two-examples.pdf.

Example 3.2.7 – 1: Special Rules for Intra-Group Financing Arrangements

Facts:

- A Co is a constituent entity located in Country A (applicable CIT rate of 10% CIT) and has an ETR of 10%.
- B Co, another constituent entity of the same MNE group, is in Country B (applicable CIT rate of 30% CIT) and is having ETR of 20%.
- A Co issues an interest-bearing instrument to B Co in exchange for cash that is treated as debt for financial account purposes but as equity for tax purposes in both Country A and Country B.
- B Co is a high-tax counterparty because, notwithstanding the above transaction, its ETR of 30% exceeds the minimum rate and therefore is not located in a low-tax jurisdiction. A Co has an ETR of 10%, which is lower than the minimum rate; therefore, A Co is a low-tax entity.
- The instrument issued between B Co and A Co is treated as interest-bearing debt for financial accounting purposes; it will increase the expenses considered in calculating the GloBE Income or Loss of A Co.

Treatment under the chapter on the computation of GloBE income or loss:

Per the article, it needs to be determined whether, over the expected duration of the arrangement, it can be reasonably anticipated that:
a. the arrangement will increase the amount of expenses considered in calculating the GloBE Income or Loss of the Low-Tax Entity (A Co);
b. without resulting in a commensurate increase in the taxable income of the high-tax counterparty (B Co).

Separately, the instrument issued between B Co and A Co is treated as equity for tax purposes in Country B and, accordingly, will not increase the taxable income of B Co in Country B. The interest expense, therefore, should be excluded from the computation of GloBE Income or Loss for A Co. Payments on the instrument; though reduces the GloBE Income or Loss of A Co, the domestic tax liability of A Co is not reduced. However, the payments on the instrument increase the GloBE Income or Loss of B Co while not increasing the Country B domestic tax liability of B Co. Thus, because of the issuance of this instrument, the ETR for GloBE purposes of Country A will be increased, and the ETR of Country B will be decreased.

Example 3.2.7 - 2 Special Rule for Intra-Group Financing Arrangements and use of tax attributes that would not otherwise be used to increase the ETR of a Low-Tax Entity

- The facts are the same as above, except that the instrument issued between B Co and A Co is treated as debt for tax purposes in Country A and Country B.
- At the time the instrument is issued, A Co is highly levered and cannot deduct any additional interest expense for Country A tax purposes.
- B Co is also highly levered and has carried forward previously denied interest expense deductions for Country B tax purposes sufficient to cover the interest income concerning the instrument issued between B Co and A Co.

Treatment under the chapter on the computation of GloBE income or loss:

The interest expense increases the amount of expenses considered in calculating the GloBE Income or Loss of A Co. However, there is no commensurate increase in the taxable income of B Co. This is because B Co does not incur a commensurate increase in its Country B taxable income with respect to the interest income received from A Co, given its excess interest expense carry-forward.

Therefore, the interest expense with respect to the instrument issued between B Co and A Co shall be excluded from the computation of GloBE Income or Loss for A Co.

Article 3.2.8 Election to consolidate transactions in the same jurisdiction

It provides an option to opt for an election (the election is a five-year election) that permits consolidated accounting treatment to be applied to transactions between constituent entities of the same MNE Group located in the same jurisdiction. If this election is made, income, expenses, gains, and losses resulting from transactions between the constituent entities may be eliminated from the computation of GloBE income or loss in the same manner as amounts relating to transactions among members of a consolidated group are eliminated as part of the consolidation adjustments under the acceptable financial accounting standard used by the UPE in preparing its consolidated financial statements.

Article 3.2.9 Exclusion of certain insurance company income

It excludes certain income of an insurance company from the computation of GloBE Income. Insurance companies are sometimes subject to current tax on returns that must be contractually paid to policyholders. The insurance company passes that tax along to the policyholders through a charge so that the company is, in effect, reimbursed for taxes paid, in some sense, on behalf of the policyholder. It is usually the case that the insurance company passes that tax along to the policyholders through a charge, specifically by way of a reduction in policy liabilities equivalent to the tax. The reduction is recognized as income, so the company is reimbursed for taxes paid on behalf of the policyholder.

Article 3.2.10 Additional Tier One Capital

Additional Tier One Capital[28] is generally treated as equity for financial accounting purposes. But it is treated as debt for tax purposes in some Inclusive Framework jurisdictions. Accordingly, in many constituent entities, for tax purposes, payments concerning Additional Tier One Capital are deductible as interest expense by the issuer and includible as interest income of the holder. This creates a permanent difference item. Therefore, per Article 3.2.10, increases or decreases to the equity of a constituent entity attributable to distributions in respect of Additional Tier One Capital shall be treated as income or expense in the computation of its GloBE Income or Loss.

Article 3.2.11

Article 3.2.11 requires adjustments to a constituent entity's financial accounting net income or loss to reflect the requirements of Chapters 6[29] and Chapter 7[30] of the GLoBE rules where necessary. For example, suppose a constituent entity used the fair value of that asset to compute its depreciation

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[28] Refer Ibid 9, pg. 52, Article 10.1.1 provides the definition - Additional Tier One Capital means an instrument issued by a Constituent Entity pursuant to prudential regulatory requirements applicable to the banking sector that is convertible to equity or written down if a pre-specified trigger event occurs and that has other features which are designed to aid loss absorbency in the event of a financial crisis."

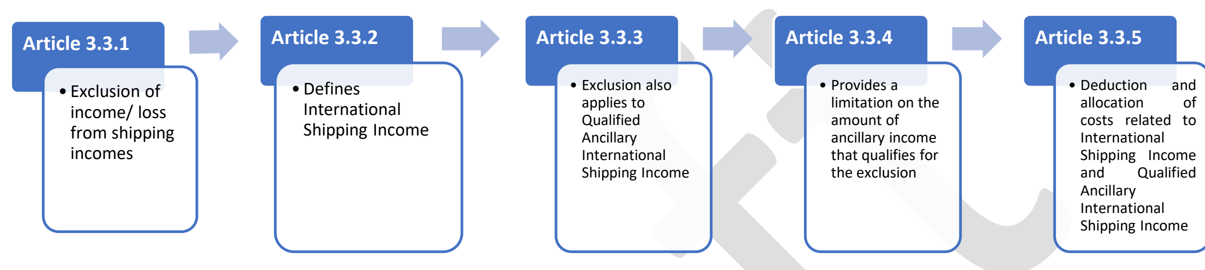
[29] Chapter 6 deals with corporate restructurings and holding structures

[30] Chapter 7 deals with tax neutrality and distribution regimes

expense for the Fiscal Year vis-à-vis the historical carrying value of an asset under Article 6.2. In that case, the depreciation expense needs to be adjusted to the amount that would have been computed using the historical carrying value of the asset.

3.3: Specific exclusion for International Shipping Income and Qualified Ancillary International Shipping Income

Alternative tax regimes are widely available for treating this income across countries. Therefore, including international shipping in the scope of the GloBE Rules may raise policy questions. The article is divided into five sub-articles (as shown below):



Article 3.1.1 states that income from International Shipping Income and Qualified Ancillary International Shipping Income is to be excluded from the computation of GloBE income/ loss of the constituent entity. To qualify for this exclusion, the constituent entity must demonstrate that the strategic or commercial management of all ships concerned is effectively carried on from within the jurisdiction of the constituent entity.

Article 3.3.2 defines International Shipping Income. Net income obtained from transporting passengers or cargo by ships via inland waterways within the same jurisdiction is excluded.

Article 3.3.3 limits the amount of ancillary income that qualifies for the exclusion. The rationale for the limitation is that ancillary activities should only qualify for the exclusion where they provide the necessary support to the primary activity of the international shipping operation. Article 3.3.4 provides the condition of meeting the 50% cap to exclude this income *'The aggregated Qualified Ancillary International Shipping Income of all Constituent Entities located in a jurisdiction shall not exceed 50% of those Constituent Entities' International Shipping Income.'*[31] The main reason for the limitation here is that ancillary activities qualify for the exclusion only where it provides necessary support to the primary activity of the international shipping operation.

Article 3.3.5 deals with the deduction and allocation of costs related to International Shipping Income and Qualified Ancillary International Shipping Income. Costs directly incurred by the constituent entity from the operation of an international shipping business are allocated based on facts and circumstances to compute the net income of a constituent entity from international shipping activities.

Certain examples provided in the Illustrative Examples published by OECD are[32]:

[31] Refer to Article 3.3.4, ibid no.1

[32] Tax Challenges Arising from the Digitalisation of the Economy –Global Anti-Base Erosion Model Rules (Pillar Two) Examples, OECD (2022), pg. 32-22, https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisationof-the-economy-global-anti-base-erosion-model-rules-pillar-two-examples.pdf.

Example 3.3.1 – 1 Exclusion of International Shipping Income and Qualified Ancillary International Shipping Income from GloBE Income or Loss

Facts

- The financial accounting net income of the constituent entity is EUR 200. Out of this,
  - EUR 60 relates to income derived from performing an activity that is not covered in this Article
  - EUR 100 relates to International Shipping Income
  - EUR 40 relates to Qualified Ancillary International Shipping Income

Treatment under this chapter

Computation of GLoBE Income of the constituent entity	Net Income (in EUR)	
(A) Financial accounting net income or loss		200
(B) Income (other than shipping)	60	
(C) International shipping income	100	
(D) Qualified Ancillary International Shipping Income	40	
(E) Adjustments under Article 3.3.1. (C+D)		140
GloBE Income (A-E)		**60**

Example 3.3.1 – 2 Exclusion of International Shipping Income and Qualified Ancillary International Shipping Income when Qualified Ancillary International Shipping Income exceeds the limitation provided under Article 3.3.4

Facts

- The financial accounting net income of the constituent entity is EUR 200. Out of this,
  - EUR 40 relates to income derived from performing an activity that is not covered in this Article
  - EUR 100 relates to International Shipping Income
  - EUR 60 relates to Qualified Ancillary International Shipping Income

Treatment under this chapter

Computation of GLoBE Income of the constituent entity	Net Income (in EUR)	
(A) Financial accounting net income or loss		200
(B) Income (other than shipping)	40	
(C) International shipping income	100	
(D) Qualified Ancillary International Shipping Income	60	
(E) Negative adjustment under Article 3.3.4 that limits (D) to 50%* (C)	(10)	
(F) Adjustments under Article 3.3.1. (C+D)		150
GloBE Income (A-E)		**50**

Article 3.3.4 puts a threshold cap for the exclusion of Qualified Ancillary International Shipping Income to 50% of the International Shipping Income. Therefore, this example shows that the total amount of Qualified Ancillary International Shipping Income is limited to EUR 50.

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Example: Article 3.3.1-3: Exclusion of International Shipping Loss and Qualified Ancillary International Shipping Loss

Facts

- The financial accounting net income of the constituent entity is EUR 200. Out of this,
  - EUR 360 relates to income derived from performing an activity that is not covered in this Article
  - EUR 100 relates to International Shipping Income
  - EUR 60 relates to Qualified Ancillary International Shipping Income

Treatment under this chapter

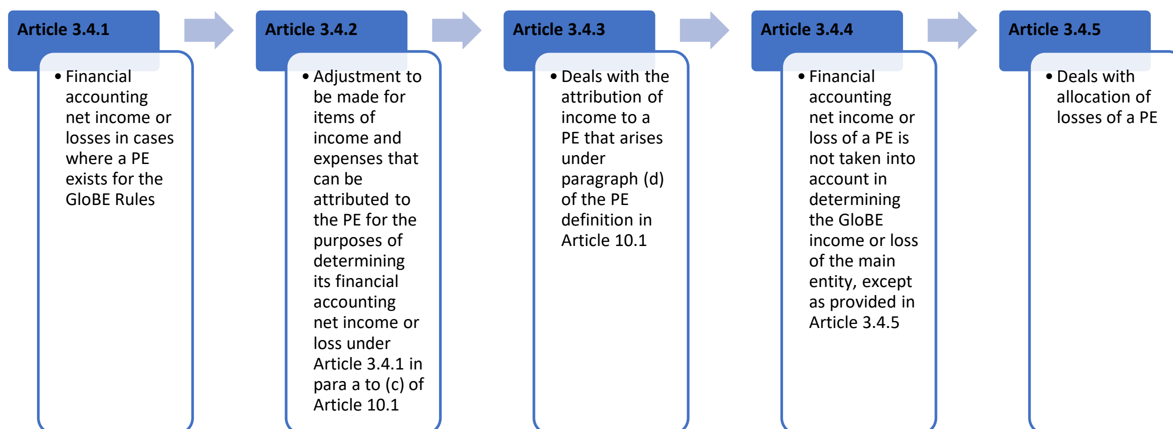
Computation of GLoBE Income of the constituent entity	Net Income (in EUR)	
(A) Financial accounting net income or loss		200
(B) Income (other than shipping)	360	
(C) International shipping income	(100)	
(D) Qualified Ancillary International Shipping Income	(60)	
(E) Adjustments under Article 3.3.1. (C+D)		(160)
GloBE Income (A-E)		**360**

Article 3.4: Allocation of income between a Main Entity and a PE

This article aims to ensure that the right amount of financial accounting net income or loss is allocated between the Permanent Establishment (PE).[33] and main entity[34]. The aim is to treat constituent entities that are PEs and subsidiaries in the same way to compute the ETR. This article is further divided into five sub-articles (as shown below)

[33] Refer Ibid 9, pg. 63, Article 10.1.1 provides definition - Permanent Establishment means (a) a place of business (including a deemed place of business) situated in a jurisdiction and treated as a permanent establishment in accordance with an applicable Tax Treaty in force provided that such jurisdiction taxes the income attributable to it in accordance with a provision similar to Article 7 of the OECD Model Tax Convention on Income and on Capital; (b) if there is no applicable Tax Treaty in force, a place of business (including a deemed place of business) in respect of which a jurisdiction taxes under its domestic law the income attributable to such place of business on a net basis similar to the manner in which it taxes its own tax residents; (c) if a jurisdiction has no corporate income tax system, a place of business (including a deemed place of business) situated in that jurisdiction that would be treated as a permanent establishment in accordance with the OECD Model Tax Convention on Income and on Capital provided that such jurisdiction would have had the right to tax the income attributable to it in accordance with Article 7 of that model; or (d) a place of business (or a deemed place of business) that is not already described in paragraphs (a) to (c) through which operations are conducted outside the jurisdiction where the Entity is located provided that such jurisdiction exempts the income attributable to such operations.

[34] Refer Ibid 9, pg. 60, Article 10.1.1 provides definition - Main Entity in respect of a Permanent Establishment, is the Entity that includes the Financial Accounting Net Income or Loss of the Permanent Establishment in its financial statements.



Article 3.4.1 deals with determining the financial account income/ loss of the PE in cases where PE exists for GLoBE rules. Financial accounting net income or loss for PE is:

– profit or loss reflected in separate financial accounts of PE, or

– if no separate financial accounts: profit or loss which would be reflected in separate financial accounts of PE if prepared on a standalone basis, in accordance with accounting standard used in the preparation of Consolidated Financial Accounts of UPE

Per Article 3.4.2, if the PE in Country B had separate financial accounts that reflected a greater amount because it also included other items of income that were not attributable to the PE under tax rules, then such items would not be considered in accordance with the first sentence of Article 3.4.2.

- Situation 1: Where PE satisfies para. (a) or (b) of the definition of PE in Article 10.1.1, adjustment is made to reflect only the amounts and items of income and expense that are attributable to the PE per the applicable tax treaty or domestic law of the jurisdiction where it is located, regardless of the amount of income subject to tax and the amount of deductible expenses in that jurisdiction
- Situation 2: If PE satisfies para. (c) of definition, adjustment is made to reflect only the amounts of income and expense that would have been attributed to it in accordance with Article 7 of the OECD Model Tax Convention

Article 3.4.3 describes the attribution of income to a PE that arises under paragraph (d) of the PE definition in Article 10.1. Per Article 3.4.4, financial accounting net income or loss of a PE (as adjusted by Article 3.4.2 and Article 3.4.3) is not considered in determining the GloBE income or loss of the main entity, except as provided in Article 3.4.5.

Per Article 3.4.5, GloBE loss of PE is treated as an expense of the main entity (and not of PE) to the extent such losses are included as an expense in the computation of domestic taxable income of the main entity and are not set off against taxable income in both jurisdictions. Subsequent GloBE Income of PE is treated as GloBE Income of Main Entity (and not of PE) up to the amount of that previous GloBE Loss.

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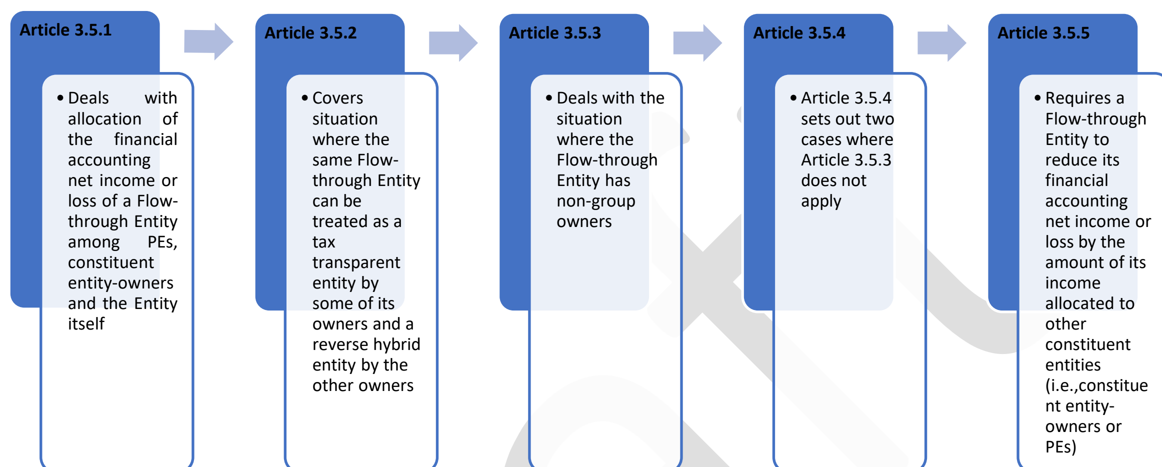
Article 3.5: Allocation of income derived through a Flow-through Entity to other Constituent Entities

This article deals with how the GloBE Income or Loss of a Flow-through Entity should be allocated between different Constituent Entities. Flow-through Entities can be tax transparent entities.[35] or reverse hybrid entities[36].

The article is divided into five sub-articles (as shown below):



Article 3.5.1 enlists the steps for allocating the financial accounting net income or loss of a flow-through entity among PEs, constituent entity-owners and the entity itself. At first, the financial accounting net income or loss of the flow-through entity is allocated to a PE; then, the residual amount is allocated to direct owners. However, an exception applies for UPEs and reverse hybrids where residual financial accounting net income or loss is allocated to the entity itself and not its ownership interest holders.

Article 3.5.2 states that Article 3.5.1 applies separately concerning each of the ownership interests in the flow-through entity under the applicable tax rules. It recognizes that the same flow-through entity can be treated as a tax-transparent entity by some of its owners and a reverse hybrid entity by its other owners.

Article 3.5.3 reduces the financial accounting net income or loss of the flow-through entity by the amount that belongs to the non-group owners.

Article 3.5.4 sets out two cases where Article 3.5.3 does not apply. These two cases cover (aan) the case where the UPE is a flow-through entity, (b) the situation where a flow-through UPE holds the flow-through entity through a tax transparent structure.

Article 3.5.5 requires a flow-through entity to reduce its financial accounting net income or loss by the amount of its income allocated to other constituent entities (constituent entity owners or PEs). This is necessary to avoid double counting that income or loss under the GloBE rules.

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[35] Ibid n. 1, pg. 80, para 205 – 'A flow-through entity is tax transparent entity where the direct owners of the Entity treat the entity as fiscally transparent.

[36] Ibid n. 1, pg. 80, para 205 – 'A flow-through entity is treated as a reverse hybrid entity where the direct owners treat the entity as opaque or not fiscally transparent.

4. Conclusion

The discussion in the chapter lays down the range of adjustments that need to be made to financial accounting net income or loss to arrive at the GLoBE income or loss. The adjustments that are required to be undertaken may vary from company to company based on different criteria like the nature and types of the transactions conducted by the MNE group and its constituent entities during the Fiscal year.

For undertaking the calculation under this chapter, a lot of data gathering exercise from different stakeholders (say from the accounting, financial reporting team) in the MNE group needs to be done. In the initial years of application, it may be challenging undertake the complex calculation (for ex., to set the processes in place to get all the data points, use the right technology solutions for application of increased automation in the calculation). However, once processes are set up overtime, the in-house tax team running the calculation or the consultants running the calculation for their clients may find it less challenging to undertake this calculation.

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